



Opportunity (Almost) Lost

Why the Only Option for Alberta is to Save

A submission to the Alberta Financial Investment
and Planning Advisory Commission
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ABOUT THE CANADIAN TAXPAYERS FEDERATION

The Canadian Taxpayers Federation (CTF) is a federally incorporated, non-profit and non-partisan, advocacy organization dedicated to lower taxes, less waste and accountable government. The CTF was founded in Saskatchewan in 1990 when the *Association of Saskatchewan Taxpayers* and the *Resolution One Association of Alberta* joined forces to create a national taxpayers organization. Today, the CTF has over 64,000 supporters nationwide.

The CTF maintains a federal office in Ottawa and offices in the five provincial capitals of British Columbia, Alberta, Saskatchewan, Manitoba and Ontario. In addition, the CTF has a working partnership with the Montreal-based *Quebec Taxpayers League*. Provincial offices conduct research and advocacy activities specific to their provinces in addition to acting as regional organizers of Canada-wide initiatives.

CTF offices field hundreds of media interviews each month, hold press conferences and issue regular news releases, commentaries and publications to advocate the common interest of taxpayers. The CTF's flagship publication, *The Taxpayer* magazine, is published six times a year. An issues and action update called *TaxAction* is produced each month. CTF offices also send out weekly *Let's Talk Taxes* commentaries to more than 800 media outlets and personalities nationally.

CTF representatives speak at functions, make presentations to government, meet with politicians, and organize petition drives, events and campaigns to mobilize citizens to effect public policy change.

All CTF staff and board directors are prohibited from holding a membership in any political party. The CTF is independent of any institutional affiliations. Contributions to the CTF are not tax deductible.

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SUMMARY OF RECOMMENDATIONS

RECOMMENDATION #1

Pass legislation requiring all non-renewable resource revenues (less the amount allowed for spending in the *Fiscal Responsibility Act*) be placed in a new *Future Fund*.

RECOMMENDATION #2

Amend the *Fiscal Responsibility Act* to roll-back the initial spending amount of non-renewable resource revenues used for spending to \$0 by 2018-19.

RECOMMENDATION #3

Use the \$5.2-billion in un-allocated dollars in the *Sustainability Fund* as the initial deposit for the newly created *Future Fund*.

RECOMMENDATION #4

A successful public referendum be required to establish the new savings fund, the savings formula and the distribution of interest revenues.

RECOMMENDATION #5

A successful public referendum be required for any changes to the savings formula, distribution of interest revenues or withdrawal from the fund.

INTRODUCTION

Ever since oil was first struck in Leduc, Alberta in 1947, Albertans and their government have benefited from the billions of royalty revenues paid to the treasury through their sale.

Unfortunately, those revenues have been anything but consistent over the long-run, due almost entirely to the fact prices have not been consistent. Commodity prices for oil are set on the world market and for natural gas on a North American market – resulting in the Alberta government having no control over the level of revenues received.

This unpredictability would not be a concern for the government if they treated these revenues like a windfall or a one-time lottery win, they are not. Non-renewable resource revenues have in the past and present been treated like any other source of revenue.

Through much of the past two-and-a-half decades the Alberta government has spent these revenues for on-going programs and capital projects. This reliance has inevitably led to crisis situations when world prices drop and revenues dry-up. Gaping revenue holes have been filled by borrowing or cutting spending.

Attempts in the past have been made to convert these one-time, unreliable, non-renewable revenues into annual, reliable, renewable revenues through savings, but in recent history these attempts have been ad-hoc and insignificant.

Alberta is once again on a fiscal crash-course. Reliance on non-renewable resource revenues for on-going spending is nearing all-time highs. If (and when) resource prices crash, the Alberta government's finances will be left with a large revenue gap. This gap will be filled through deficits, spending cuts and/or tax hikes. The only other option is if the Alberta government is able to create a new stable source of renewable revenues *before* prices drop or spending out-strips even these record-high prices. This can only be accomplished if the Alberta government controls spending and begins saving.

Much has been made in the way of big ideas or opportunities that could be accomplished if only the Alberta government were to start saving. The Canadian Taxpayers Federation (CTF) in 2001 released a report by Dr. Jean-Francois Wen of the University of Calgary showing Alberta could have been completely income-tax free by 2015 had 50 per cent of resource revenues been saved. These “blue-sky” opportunities are great, and need to happen, but they can only be fathomed after the government replaces the money they currently rely upon for on-going programs (without spending cuts or tax hikes). The window of opportunity for savings is closing, unless action is taken now, it will soon be too late.

The CTF recommends in this paper that, the Alberta government set as their goal to increase savings (and thereby interest revenues) to a point where resource revenues are no longer required for on-going yearly program spending. In short, convert non-renewable resource revenues into renewable revenues through the use of savings.

WHY THE NEED TO SAVE?

Over the past 20 years, the Alberta government has received \$116-billion in non-renewable resource revenues.

These assets are, in principle, owned equally by every single Albertan and the distribution of their value has been handled by the Alberta government.

These one-time funds have been used over the past 20 years for virtuous reasons and those less virtuous. Under the virtuous category would be debt repayment and savings. Under the less virtuous category would be spending.

Of the \$116-billion, it can be suggested that \$22.7-billion was used for debt repayment and \$20.2-billion was used for servicing that debt. Of the remaining \$73.2-billion, \$19.1-billion has been put towards savings (*Heritage Fund*, endowment funds, *Sustainability Fund*, others)^a, and virtually all of the remainder (over \$54-billion or 47 per cent) has been put towards spending (on-going and capital).

Just like running a debt is transferring a financial burden from one generation to another, refusing to save these one-time resource revenues is theft of a windfall – owned by all Albertans, present and future – from one generation by another.

The opportunity that could have been created by these revenues was tremendous, but is all but lost.

For example, in 2000, the CTF commissioned a study by Dr. Jean-Francois Wen of the *University of Calgary*. Dr. Wen was asked if it would be possible for Alberta to build up the *Heritage Fund* and then use the interest to eliminate personal income taxes.

Dr. Wen determined if the government held the line on spending increases starting in 2001, and dedicated 50 per cent of all resource revenues to the *Alberta Heritage Savings Trust Fund*, along with retaining all of the interest generated by the fund, Alberta could eliminate personal income taxes by 2015. Furthermore, his study was based on oil priced at \$18/barrel and natural gas at \$2.35/mcf and increasing only at the rate of inflation. As we have seen with recent resource prices, the time-line suggested by Dr. Wen could have been substantially ramped up, had the Alberta government taken action in 2001.

However, the reason why the Alberta government needs to start saving has become more urgent.

In short: Alberta is too reliant on the revenues from non-renewable resources.

^a \$19.1-billion in savings determined by taking current net financial assets (\$31.6-billion) less 1987-88 net financial assets (\$6.4-billion), less cash within the *Capital Account* and above the \$2.5-billion minimum in the *Sustainability Fund* (\$11.2-billion) which are allocated for spending and not long-term savings.

Sustainable own-source revenues

“Sustainable own-source revenues” are revenues generated in Alberta through taxes, investments, premiums, fees and commercial operations. Essentially, they are all Alberta government revenues, less non-renewable resource revenues and transfers from the government of Canada.

Chart 1 – Alberta government program spending and sustainable own-source revenues from 1987-88 to 2007-08

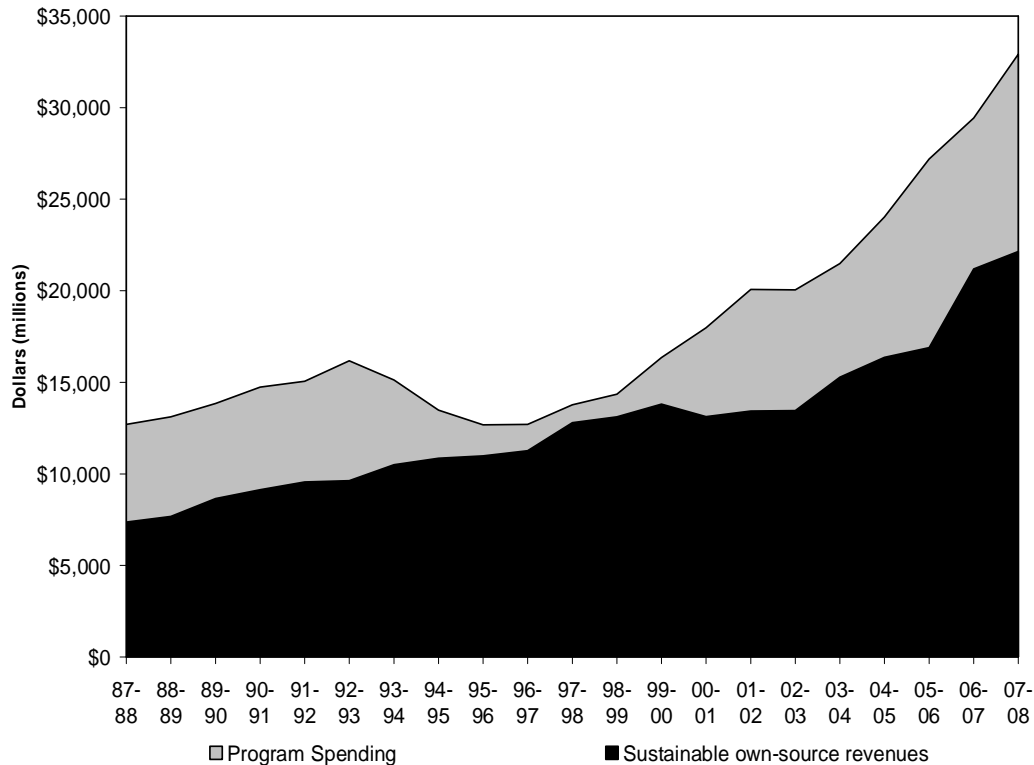


Chart 1 above illustrates the two key levels in determining long-term sustainability of any budget. The top level is program spending in millions each year. The bottom level is sustainable own-source revenues. The area shaded in grey is where the two levels don't overlap. It represents the amount of program spending being funded each year by non-renewable resource revenues or debt.

Clearly, the grey area is at its largest in the late-80s and mid-90s when Alberta was heavily reliant on debt to fund the gap. It is at its smallest in 1997-98, when sustainable own-source revenues covered 93 per cent of all program spending. However, the grey area begins to grow in 1998 as Alberta became entirely reliant on non-renewable resource revenues to fund the gap.

In fact, in 2005-06, sustainable own-source revenues covered only 62 per cent of all program spending, the lowest point of sustainability since 1992-93.

Why is this a problem?

Just as it was a problem to be reliant on debt to fund our overspending in the 1980s and early 1990s, it is a problem now to be reliant on a source of revenue that is a) depleting, b) dependent on a world price Alberta has no control over, and c) has proven to be unreliable throughout Alberta's history.

Chart 2 – Non-renewable resource revenues as a percentage of total Alberta government revenues 1981-82 to 2007-08

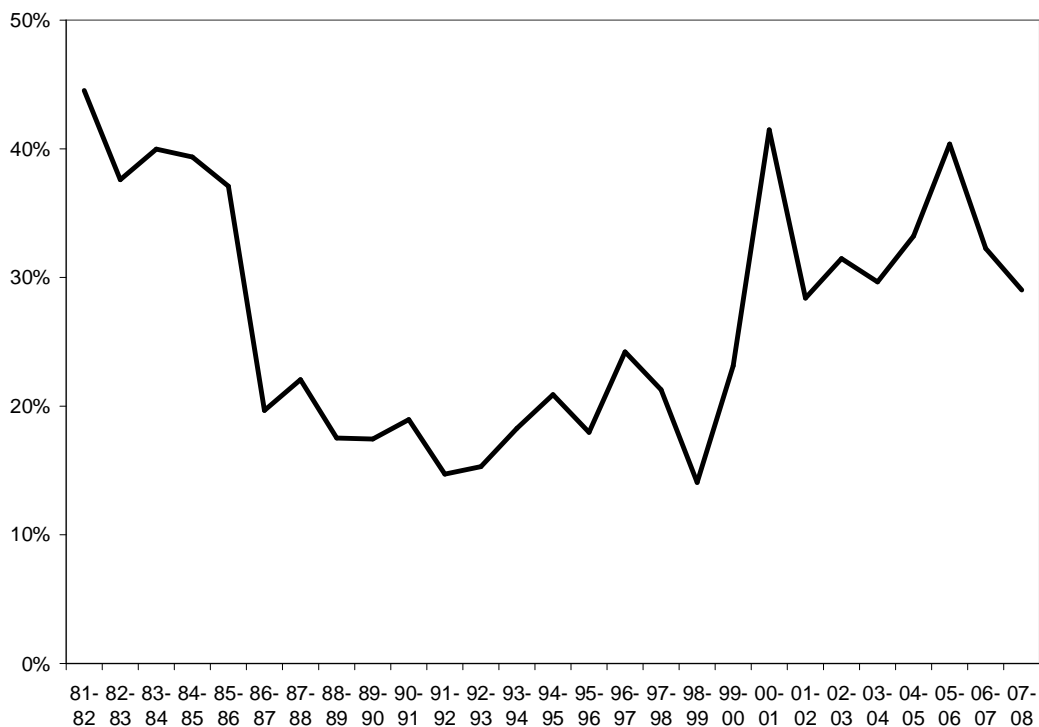


Chart 2 above illustrates exactly how erratic and unreliable non-renewable resource revenues can be. During this 27-year period, resource revenues have represented a high of 45 per cent (1981-82) of total revenues in a fiscal year to a low of 14 per cent (1998-99). Even in the past three years, the range has been from a low of 29 per cent to a high of 40 per cent.

Chart 3 – Non-renewable resource revenues (in millions) 1981-82 to 2007-08

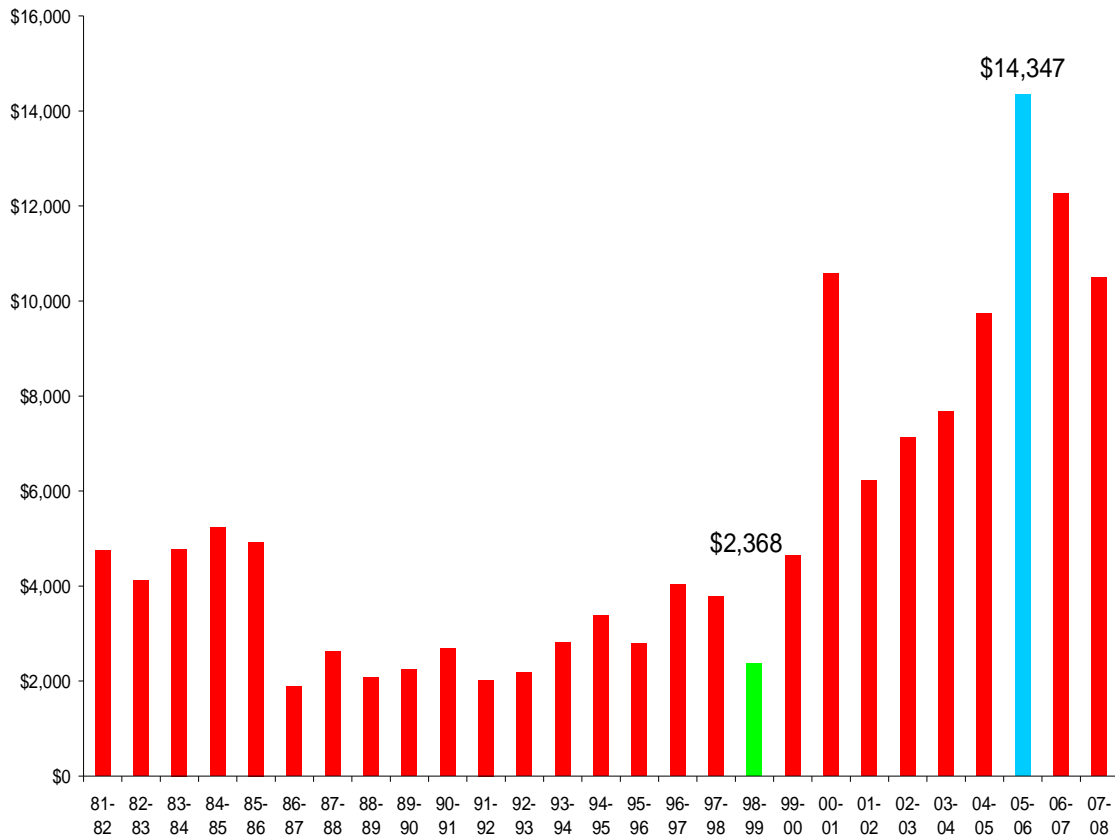


Chart 3 above illustrates that in the past decade alone, resource revenues have brought in a high of \$14.3-billion and a low of \$2.4-billion.

Not knowing how much revenue to expect makes budgeting hard, particularly when those dollars are relied upon to pay the wages of public servants like doctors, teachers and nurses.

And this has been the case in the past in Alberta.

Alberta's Past

Even knowing how unreliable non-renewable resource revenues are, the Alberta government has a long history of being heavily reliant on them, with disastrous results.

Of course, because of the government's reliance, when non-renewable resource revenues drop, action must be taken to adjust.

Throughout the past couple of decades, the reaction to a drop in non-renewable resource revenues has varied.

1986

One of the largest drops in revenue occurred in 1986-87, where total revenues were 28 per cent lower than the year previous. The decrease in revenue was almost entirely due to a significant drop in non-renewable resource revenues, which fell 61 per cent in one year (from \$4.9-billion in 1985-86 to \$1.9-billion in 1986-87), in comparison to personal income tax revenues, which increased by 16 per cent during the same period.

The Getty government did not respond in turn, by cutting spending by 28 per cent. Instead, they reduced program spending by 3.7 per cent. They financed the shortfall by running a deficit and doubling Alberta's provincial debt from \$5-billion to \$10-billion.

Undoubtedly, the Getty government hoped resource prices would rebound, as their revenues had averaged \$4.7-billion per year for Premier Lougheed's five previous budgets. However, resource revenues did not immediately rebound, averaging \$2.3-billion over the next six years.

While the Getty government is often tarred with the fiscal recklessness that led to Alberta's \$22.7-billion debt, the Lougheed government must share some of the blame.

Premier Lougheed, no doubt buoyed by strong multi-year non-renewable resource revenues, increased program spending by 17.5 per cent in Budget 1985 – his last budget.

This huge increase in spending set Premier Getty up for a fall. Had Lougheed only increased spending by 2.4 per cent in 1985 (the combined inflation and population growth rate for the previous year), Getty's small budget cuts would have had more impact and kept the provincial debt from growing as much as it did. Or, had Lougheed increased the amount of non-renewable resource revenues earmarked for savings during the five previous years that too would have helped off-set the impact of falling resource prices with investment earnings.

This trend of borrowing to cover lost non-renewable resource revenues continued each year until 1993, and created Alberta's \$22.7-billion debt. Of course, that debt led to significant program spending cuts starting in 1993.

2001

Budget 2001 saw mixed messages sent to Albertans.

On one hand you had Finance Minister Pat Nelson warn of the need to act prudently:

“The reality is we simply don’t know what might happen to oil and gas prices tomorrow let alone three years from now. No one does. Every time the price of oil goes up or down by \$1 a barrel, the province gains or loses \$153-million. And every time natural gas goes up or down by 10 cents an mcf, we gain or lose \$142-million.”

On the other hand, she tabled a budget that increased program spending by 24.5 per cent, five times higher than the combined population and inflation growth rate that year.

Unfortunately for her and for Albertans, throughout the spring and summer natural gas prices bottomed out. This drop in revenues was exasperated by a significant drop in the markets following 9/11.

The sudden drop in revenues caused the government to react. The government held an unprecedented emergency fiscal update in October 2001, froze government hiring, chopped community lottery boards, reduced departmental budgets by 1 per cent and deferred \$735-million dollars worth of capital projects, for a grand total budget cut of \$1.2-billion.

One lesson to be learned from these experiences is not to believe non-renewable resource revenues will continue to stay high, just because they have been high for the past few years. The Alberta government has no control over the price of oil or natural gas; both are set on a world market. They can fall just as easily as they climbed.

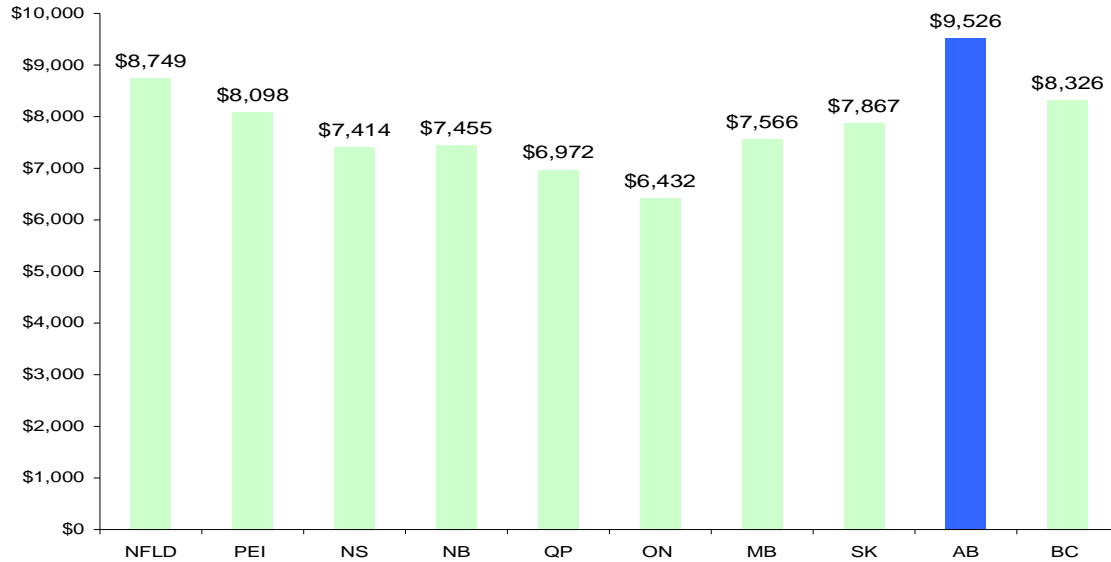
The second lesson to be learned is to not rely on your unreliable sources of revenue for core spending priorities. Cutting core services are not easily done by governments. Unnecessarily large spending increases only make the cuts deeper in the future.

Unfortunately, it doesn’t appear either of these lessons have been learned by the Alberta government.

Alberta's Present

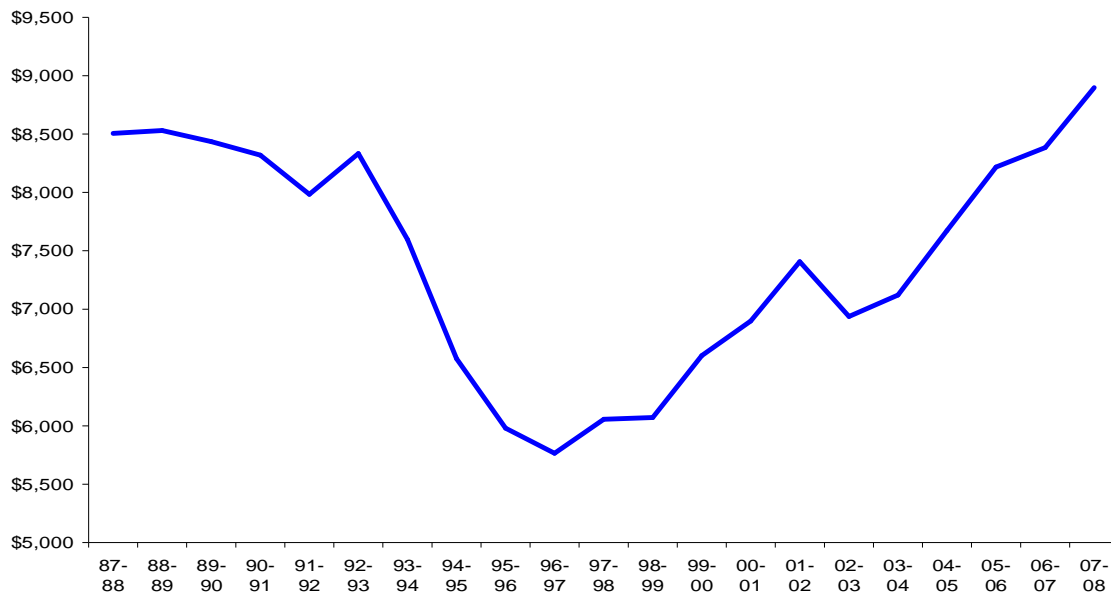
Alberta is currently, per capita, the highest spending province in Canada at \$9,526 per man, woman and child.

Chart 4 – Provincial per capita program spending in 2007-08



If you adjust for inflation, per capita growth in program spending in Alberta is, back to where it was in the mid-to-late 1980's.

Chart 5 – Per capita Alberta government program spending (in constant 2005-06 dollars) 1987-88 to 2007-08



Alberta's Future (if nothing changes)

Alberta could be put into a deficit budget position in the not too distant future.

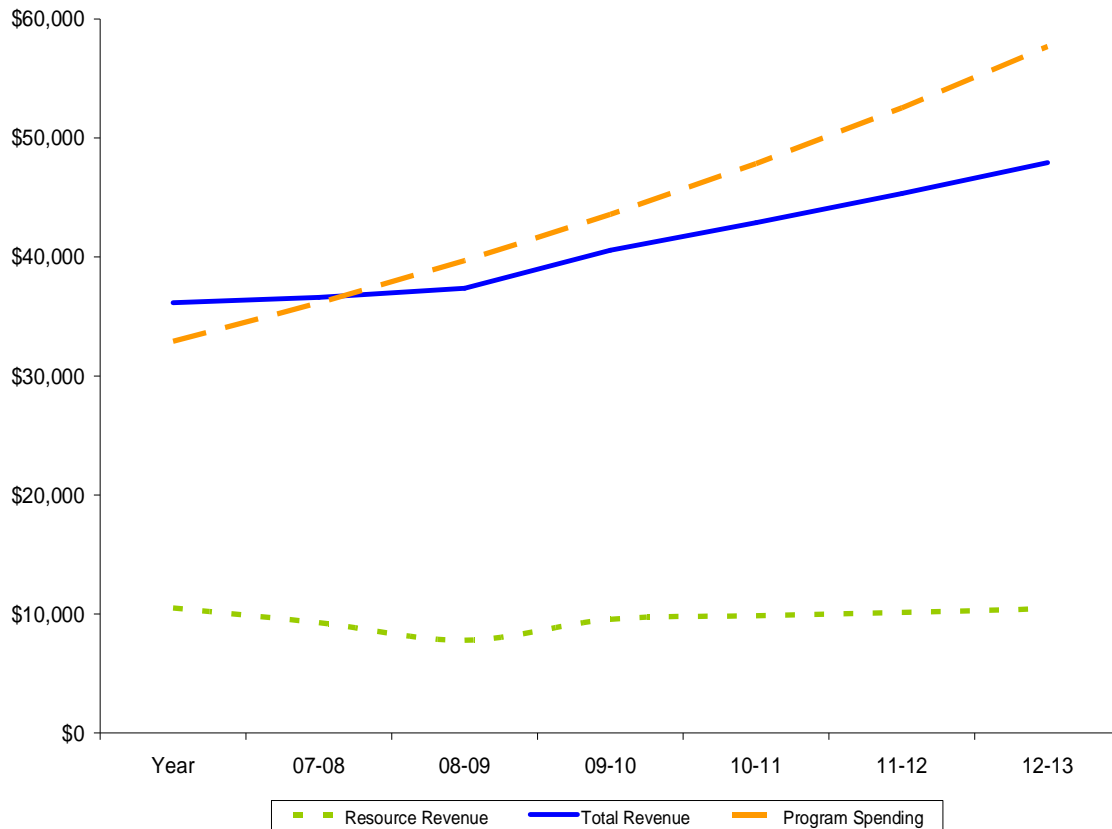
In order to determine the financial solvency of the current government, the CTF has modeled two scenarios based on ten-year average trends, and the most likely actions the Alberta government would take in the short-term.

Scenario 1

Assumptions:

- Spending growth continues at 9.8 per cent (ten-year average);
- Resource revenues fall over the next two fiscal years (as per Budget 2008 targets) and then rebound to the ten-year average level of \$9.6-billion, growing at the ten-year average inflation rate each year thereafter (3 per cent);
- Other revenues continue to grow at 6.5 per cent (ten-year average);
- No withdrawal of short or long-term savings.

Chart 6 – Scenario 1: Revenue and expenditure projection (in millions) 2007-08 to 2013-14

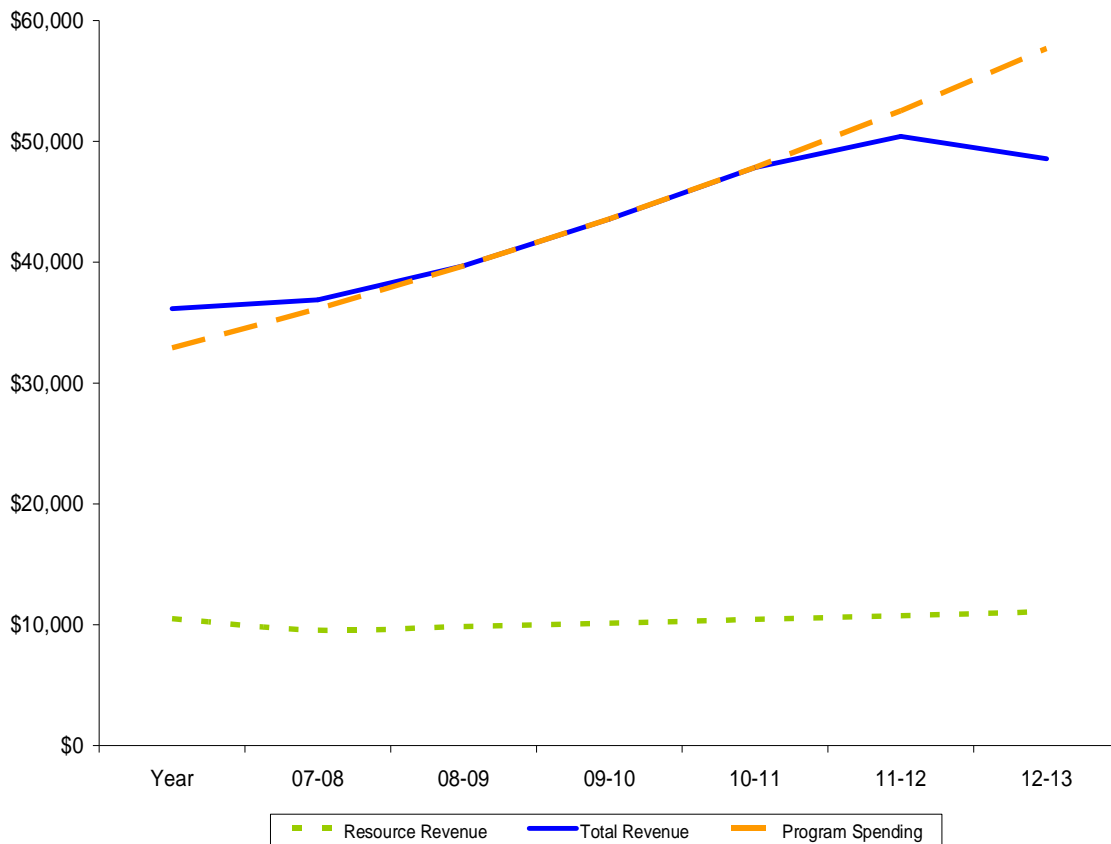


Scenario 2

Assumptions:

- Spending growth continues at 9.8 per cent (ten-year average);
- Resource revenues do not fall over the next two fiscal years (as per Budget 2008 targets) but immediately level out at the ten-year average of \$9.6-billion, growing at the ten-year average inflation rate each year thereafter (3 per cent);
- Other revenues continue to grow at 6.5 per cent (ten-year average);
- \$11.2-billion in short-term savings (\$5.2-billion in the *Sustainability Fund* & \$6-billion in the *Capital Account*) are slowly drained as necessary to keep a balanced budget.

Chart 7 – Scenario 2: Revenue and expenditure projection (in millions) 2007-08 to 2013-14



Clearly, in both scenarios, with spending growth outpacing revenue growth, the Alberta budget will fall into a deficit position.

Under scenario 1, the budget falls into a deficit position in 2009-10, yet the Alberta government retains the \$11.2-billion in short-term savings. Under scenario 2, the budget falls into a deficit position in 2012-13, and the Alberta government spends its entire short-term savings.

If current spending trends continue – unless non-renewable resource revenues are significantly higher than projected, are reliable every year and continue to grow indefinitely – Alberta will be facing a deficit position.

However, deficit budgets are illegal under the *Fiscal Responsibility Act*, so either that *Act* is going to be amended to allow for deficit budgeting, taxes are going to be increased, or spending is going to be cut in the not too distant future.

Stopping this from happening is going to take a combination of spending control and savings.

HOW TO SAVE

Create a “Future Fund”

Renewable, sustainable, own-source revenues could be obtained by raising taxes or increasing savings. Raising taxes is not an attractive option, in fact, with fiscal discipline and wise use of resource revenues, taxes should be coming down in Alberta.

The only option is to begin a significant savings program.

As of March 31, 2007, Alberta had \$34-billion in net financial assets. These assets include nine different short, medium and long-term savings accounts. Many of these funds have a specified purpose already, such as the *Alberta Cancer Prevention Legacy Fund*, the *Capital Account*, and the *Debt Retirement Account*.

The *Alberta Heritage Savings Trust Fund* is the largest of any of these accounts, at \$16.3-billion.

The *Heritage Fund* was primarily created to save for the future, to strengthen or diversify the economy and to improve the quality of life of Albertans.

It continues to serve two of these three goals today. Attempts to diversify the economy largely failed, losing millions and tarnishing the *Heritage Fund* in the eyes of many Albertans, and as such is no longer a goal.

The *Heritage Fund* has had a handful of small injections of cash during the past four fiscal years, after stagnating and losing relative value for nearly two decades. Most of these deposits were to inflation-proof the fund, however, an additional \$2-billion was invested.

These piecemeal, half-hearted attempts to save money best illustrate the problem with ad-hoc savings programs. The Alberta government needs to put in place a formula for increasing savings and subject it to law. This formula, if done correctly, will also help reduce the amount of resource revenues used for spending each year.

It would not matter whether the new savings were deposited into the current *Heritage Fund* or a new fund, as long as the explicit goal is to maximize investment income. For the purposes of this submission, the CTF recommends creating a new fund, the *Future Fund*, in which future savings would be deposited.

Create a non-renewable resource revenue savings formula

2006-07 CTF Supporter Survey

The Alberta government receives over \$10-billion per year (on average) from the sale of oil and natural gas. Currently, the vast majority of this money is spent on on-going programs (health, education, etc) and capital building projects. These revenues, unlike traditional tax revenues, are one-time, un-reliable revenues that may or may not be there each year. Do you think the government should:

Continue to spend these one-time revenues each year on on-going programs and capital projects that need annual funding (Spend 100%)	4 %
Not spend any of these one-time revenues (Save 100%)	4%
Spend 25%, Save 75%	28%
Spend 50%, Save 50%	44%
Spend 75%, Save 25%	20%

CTF supporters overwhelmingly support putting a significant portion of resource revenues into savings. 96 per cent of supporters feel the government should save at least 25 per cent of annual resource revenues. 76 per cent feel the government should save at least 50 per cent of annual resource revenues.

However, the CTF no longer prescribes to a fixed percentage (ie. 50 per cent) be put towards savings, but rather a fixed cap on non-renewable resource allowed to be used for spending, with all of the remained going into savings.

The level of resource revenues allowed for spending must be prescribed in the *Fiscal Responsibility Act*.

Example:

2007-08 non-renewable resource revenue:	\$10.5 billion
Less amount for program spending:	\$ 5.3 billion

Remainder:	\$ 5.2-billion
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This \$5.2-billion should be, by law, deposited into a new *Future Fund* at the end of this fiscal year.

Of course, as resource prices change, the level of yearly savings would change. However, this type of formula guarantees the sustainability of program spending first. Further, with the proposed roll-back of the initial spending amount allowed for program spending (Table 1 – Page 19), more and more resource dollars would be deposited into the *Future Fund* every year.

It also would result in saving approximately 50 per cent of resource revenues in 2007-08, with that percentage changing each year and hopefully increasing into the future, depending on how much is received in non-renewable resource revenues.

Moreover, this \$5.2-billion in savings should generate an additional \$234-million to \$458-million in investment income next year^b and for each future year. If 50 per cent of that investment income was sent to general revenues and 50 per cent was retained within the *Future Fund* it would not only help off-set the non-renewable resource revenues which were traditionally spent, but would lead to compounding interest and growth of the *Future Fund*.

RECOMMENDATION #1

Pass legislation requiring all non-renewable resource revenues (less the amount allowed for spending in the *Fiscal Responsibility Act*) be placed in a new *Future Fund*.

What about the *Sustainability Fund*?

The *Sustainability Fund* was created in 2003 with an amendment to the *Fiscal Responsibility Act*. The change allowed for the first \$3.5-billion in resource revenues to go into general revenues, with the excess flowing into a new \$2.5-billion *Sustainability Fund*.

The intent was two-fold: first, to use the money in the *Sustainability Fund* to cover any shortfall if resource revenues did not amount to \$3.5-billion in a fiscal year, and second, to keep the government from using more than a minimum amount (\$3.5-billion) of non-renewable resource revenues for yearly program spending, thereby reducing reliance.

Further provisions were put into the *Act* so if the balance of the fund was over \$2.5-billion, funds could be transferred out into the *Capital Account* or into “balance sheet improvements” (read: spending).

With the fund reaching its \$2.5-billion goal in the first year, non-renewable resource revenues almost immediately began to flow back into program spending and into the *Capital Account*.

No amendments have been made to legally increase the \$2.5-billion minimum requirement for the *Sustainability Fund*, and since the government is allowed to “allocate” all funds above the \$2.5-billion level, spending is encouraged instead of restrained.

However, the government has amended the *Act* to increase the initial level of resource revenues used for program spending and budgeting. The *Fiscal Responsibility Act* was

^b Investment income based on Heritage Fund expected long-term return (4.5% plus CPI) and five-year real average return on investment in the *Alberta Heritage Savings Trust Fund* of 8.8% per year.

amended in 2004 to increase the initial amount of resource revenue spending from \$3.5-billion to \$4-billion. The *Act* was subsequently amended in 2005 to increase the initial amount of resource revenue spending to \$4.75-billion. Now becoming an annual tradition, in 2006, the *Act* was once again amended to increase the spending amount to \$5.3-billion, where it was frozen in 2007.

The Alberta government must not just freeze, but reverse the trend of increasing the amount of non-renewable resource revenues for budgeting.

The government should, starting with Budget 2008, amend the *Fiscal Responsibility Act* with a roll-back schedule to eventually eliminate the necessity to use non-renewable resource revenues for program spending altogether.

Table 1 - Proposed roll-back of the *Fiscal Responsibility Act*

Fiscal Year	<i>Fiscal Responsibility Act</i> Spending Cap
2008-09	\$5.6-billion
2009-10	\$5.3-billion
2010-11	\$5.0-billion
2011-12	\$4.7-billion
2012-13	\$4.3-billion
2013-14	\$3.5-billion
2014-15	\$3.0-billion
2015-16	\$2.2-billion
2016-17	\$1.3-billion
2017-18	\$0.3-billion
2018-19	\$0.0-billion

RECOMMENDATION #2

Amend the *Fiscal Responsibility Act* to roll-back the initial spending amount of non-renewable resource revenues used for spending to \$0 by 2018-19.

Changes also must be made to limit the ability to spend non-renewable resource revenues from within the *Sustainability Fund*.

While officially, only \$5.3-billion in resource revenues are used for program spending each year, the true amount is significantly higher. Excess resource revenues flow into the *Sustainability Fund* and much are transferred into the *Capital Account* for future spending or used for natural disaster/emergency and natural gas rebate spending.

Virtually every single resource revenue dollar gets spent.

Where did \$12.3-billion in non-renewable resource revenues go in 2006-07?

Non-renewable resource revenues:	\$12.3 billion
Used for budgeting:	<u>\$ 5.3 billion</u>
Net transferred into the <i>Sustainability Fund</i> :	\$ 7.0 billion
Transferred out into the <i>Capital Account</i> :	\$ 3.0 billion (for that year's spending)
	\$ 1.8 billion (for future year's spending)
Spend on disasters/natural gas rebates:	<u>\$ 0.9 billion</u>
Remainder:	\$ 1.2 billion

Further, there is still currently \$5.2-billion in un-allocated dollars in the *Sustainability Fund*, on top of the \$2.5-billion minimum (\$7.7-billion total in the *Sustainability Fund* as of the First Quarter Budget Update).

Having un-allocated dollars sitting in an account that can and has been used primarily for spending is unacceptable.

RECOMMENDATION #3

Use the \$5.2-billion in un-allocated dollars in the *Sustainability Fund* as the initial deposit for the newly created *Future Fund*.

SAVINGS FORMULA

Clearly the ad-hoc nature of savings over the past few years has not resulted in significant levels of savings, nor restriction in government spending of non-renewable resource revenues. A legal formula is absolutely needed.

Deciding which type of formula to use is essential.

Some have suggested a percentage of non-renewable resource revenues be saved, including the Canada West Foundation (50 per cent), the Alberta Liberal Party (33 per cent), and the Alberta Chambers of Commerce and the Certified General Accountants Association of Alberta (30-40 per cent). Even the Canadian Taxpayers Federation had, in the past, recommended 50 per cent of non-renewable resource revenues be saved.

The first problem with using a percentage is that it offers the government limited flexibility when revenues are low, and too much freedom to spend when revenues are high.

For example, if the Alberta government is planning on spending \$5.3-billion of non-renewable resource revenues because of the spending limit dictated in the *Fiscal Responsibility Act*, if non-renewable resource revenues come in at \$8-billion, with a 50 per cent savings requirement, this will only leave \$4-billion for government program spending. This may result in tax hikes or spending cuts to cover the shortfall.

Alternatively, if \$14-billion is received in non-renewable resource revenues, only \$7-billion would be saved, leaving \$7-billion for government program spending, \$1.7-billion more than allowed under the *Act*. This may encourage unnecessary increases in government spending.

Presumably, the Alberta government would be able to easily handle too much money, but they would not appreciate too little. This may force the government to annually adjust the formula as they see fit, thereby, neutering the purpose of having a legal formula.

By first setting a minimum amount of money guaranteed each year for spending and putting the remainder into savings, this would reduce the likeliness of the Alberta government adjusting the formula each year.

For example, if the Alberta government is planning on spending \$5.3-billion of non-renewable resource revenues as per the *Fiscal Responsibility Act*, and non-renewable resource revenues come in at \$8-billion, the Alberta government would get the first \$5.3-billion, and the remainder, \$2.7-billion, would be put into savings. This would be the equivalent of 34 per cent going to savings. Alternatively, if \$14-billion of non-renewable resource revenues were received, again the first \$5.3-billion would go into general revenues for program spending, with the remainder, \$8.7-billion going into savings. This would be the equivalent of 62 per cent going into savings.

While savings are still guaranteed under this type of formula, the main benefit is that it doesn't pit spending versus savings in years when non-renewable resource revenues are low.

The second issue is that some have suggested the government would be loath to change the formula if it were a percentage rather than a fixed amount. History has not proved this to be true.

The Lougheed government put in place a 30 per cent savings rule for non-renewable resource revenues from 1976 to 1982. In 1982, the Lougheed government reduced the savings amount to 15 per cent and the Getty government reduced that to zero in 1987^c.

As we've seen in the past few years, when the government has to choose between spending and saving, savings get ignored.

^c Warrack, Allan. "Alberta Heritage Fund: Blessing Becoming Curse?" Management éthique et développement durable Laboratoire du Centre Recherche de Bordeaux Ecole de Management, December 2005. Pg. 10

PROTECTION

The creation of a new *Future Fund* or significant change in direction for the current *Alberta Heritage Savings Trust Fund* is going to need not only political buy-in, but public buy-in. As such, it should not be established without the explicit consent of Albertans.

As was done with the *Alaska Fund*, a referendum should be held in order to establish the fund, the savings formula and the distribution of interest revenues.

If successful, legislation should be passed barring current or future governments withdrawing funds and requiring a subsequent referendum be held to allow any significant changes or withdrawal of funds.

As Dr. Allan Warrack points out, political and public buy-in is one of the primary reasons why the *Alaska Fund* has been more successful than the *Alberta Heritage Savings Trust Fund*:

“A crucial difference is that the Alaska Permanent Fund (APF) was established by Constitutional Amendment; a referendum was necessary to establish APF, and Alaska citizens voted to pass such a referendum. As a result, APF monies were set aside for the future, away from current fiscal budgetary pressures. It was specified that a minimum portion of energy resources monies (25%) must be directed to APF, and the Fund would be managed by an “arms-length” Board of Trustees. By contrast, Alberta’s Fund was established by ordinary legislative process. Flows of funds could be and were interrupted (1987 to present), and worst, with AHF yields entirely diverted to current budgets (1982 to present)^d.”

While Alberta does not have a constitution, the moral and political suasion of a successful referendum would likely keep short-term political “crises” from undoing the long-term work and goals of the *Future Fund*.

RECOMMENDATION #4

A successful public referendum be required to establish the new savings fund, the savings formula and the distribution of interest revenues.

RECOMMENDATION #5

A successful public referendum be required for any changes to the savings formula, distribution of interest revenues or withdrawal from the fund.

^d Warrack, Allan. “Alberta Heritage Fund: Blessing Becoming Curse?” *Management éthique et développement durable Laboratoire du Centre Recherche de Bordeaux Ecole de Management*, December 2005. Pg. 13

WHAT WOULD HAPPEN?

If all of these recommendations were followed, how long would it take to grow the new *Future Fund* to a point where Alberta was no longer reliant on non-renewable resource revenues?

We have done two scenarios, one based on investment returns of 8.8 per cent and a spending freeze for 2008-09, the other based on investment returns of 4.5 per cent and no spending freeze for 2008-09.

Scenario 1

Assumptions:

- All non-renewable resource revenues over and above the minimum amount prescribed for program spending be put into the *Future Fund*;
- Resource revenues fall over the next two fiscal years (as per Budget 2008 targets) and then rebound to the ten-year average level of \$9.6-billion, growing at 3 per cent each year (ten-year average inflation rate);
- Other revenues continue to grow at 6.5 per cent each year (ten-year average);
- Program spending is frozen in 2008-09 and then grows at 5.1 per cent per year (ten-year population and inflation growth rate average);
- Interest is generated in the *Future Fund* at a rate of 8.8 per cent (five-year average of the *Alberta Heritage Savings Trust Fund*);
- \$5.2-billion from the *Sustainability Fund* be used to start-up the *Future Fund*;
- 50 per cent of interest revenues are sent to the General Revenue Fund;
- 50 per cent of interest revenues are retained within the *Future Fund*.

Table 2 – Scenario 1 – Financial Information (in millions) 2008-09 to 2024-25

Year	Resource Revenue (RR)	RR used for spending	RR into Future Fund	Other Revenues (OR)	Total Revenues	Program Spending	Surplus	Future Fund Balance	Annual Interest Revenue
08-09	\$9,266	\$5,600	\$3,666	\$27,339	\$32,939	\$32,914	\$25	\$5,153	\$232
09-10	\$7,787	\$5,300	\$2,487	\$29,121	\$35,114	\$34,586	\$529	\$8,935	\$786
10-11	\$9,544	\$5,000	\$4,544	\$31,020	\$36,540	\$36,343	\$197	\$11,815	\$1,040
11-12	\$9,830	\$4,700	\$5,130	\$33,043	\$38,486	\$38,189	\$297	\$16,879	\$1,485
12-13	\$10,125	\$4,300	\$5,825	\$35,198	\$40,499	\$40,129	\$370	\$22,752	\$2,002
13-14	\$10,429	\$3,500	\$6,929	\$37,493	\$42,294	\$42,167	\$128	\$29,578	\$2,603
14-15	\$10,742	\$3,000	\$7,742	\$39,938	\$44,602	\$44,309	\$293	\$37,809	\$3,327
15-16	\$11,064	\$2,200	\$8,864	\$42,542	\$46,820	\$46,560	\$260	\$47,214	\$4,155
16-17	\$11,396	\$1,300	\$10,096	\$45,316	\$49,175	\$48,925	\$251	\$58,156	\$5,118
17-18	\$11,738	\$300	\$11,438	\$48,271	\$51,687	\$51,410	\$277	\$70,810	\$6,231
18-19	\$12,090	\$0	\$12,090	\$51,419	\$55,175	\$54,021	\$1,154	\$85,364	\$7,512
19-20	\$12,453	\$0	\$12,453	\$54,772	\$59,225	\$56,765	\$2,460	\$101,210	\$8,906
20-21	\$12,826	\$0	\$12,826	\$58,344	\$63,541	\$59,649	\$3,892	\$118,116	\$10,394
21-22	\$13,211	\$0	\$13,211	\$62,148	\$68,139	\$62,679	\$5,460	\$136,139	\$11,980
22-23	\$13,607	\$0	\$13,607	\$66,201	\$73,036	\$65,862	\$7,174	\$155,341	\$13,670
23-24	\$14,016	\$0	\$14,016	\$70,518	\$78,252	\$69,208	\$9,045	\$175,783	\$15,469
24-25	\$14,436	\$0	\$14,436	\$75,116	\$83,808	\$72,723	\$11,085	\$197,533	\$17,383

Chart 8 – Scenario 1 – Future Fund balance (in millions) 2008-09 to 2024-25

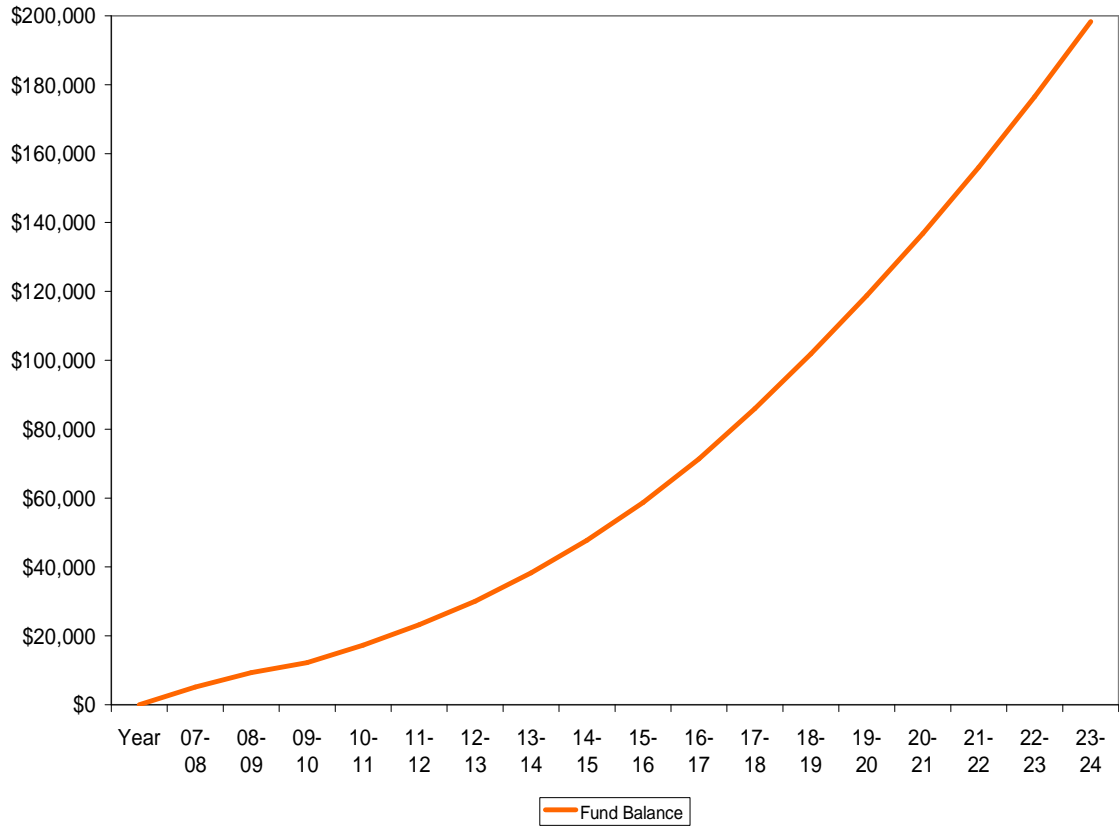
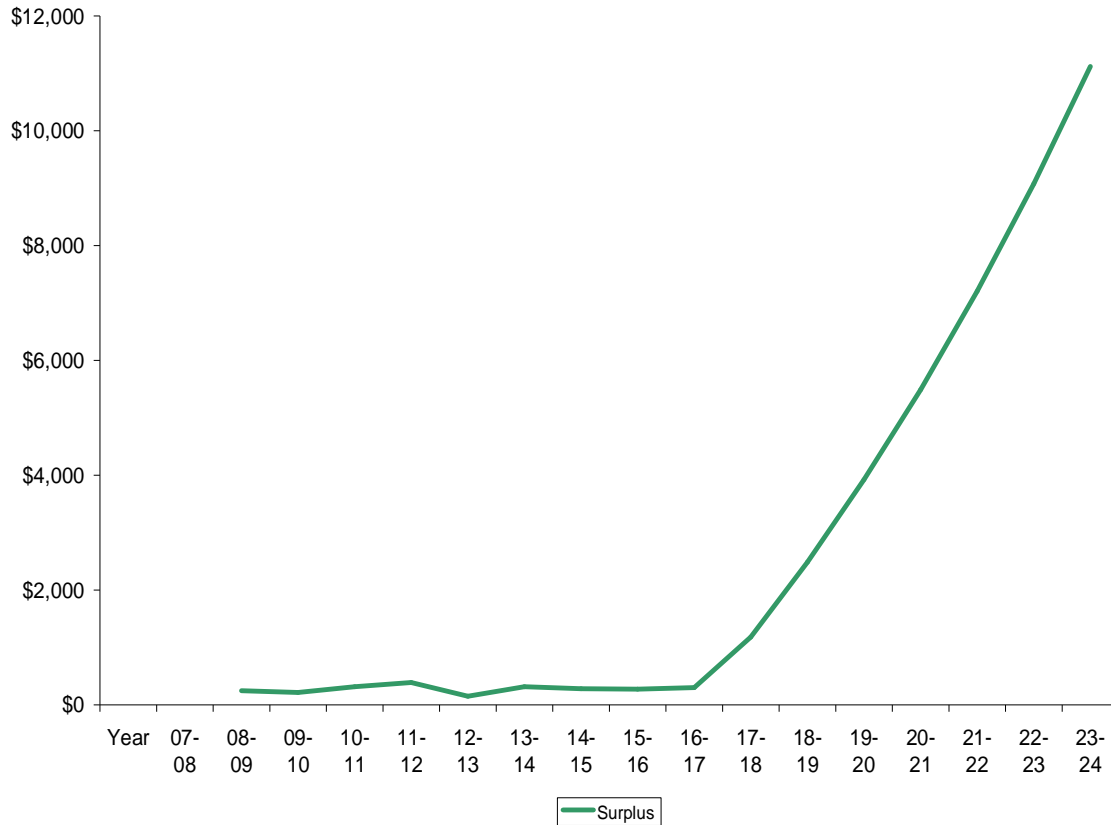


Chart 9 – Scenario 1 – Annual Surpluses (in millions) 2008-09 to 2024-25



Scenario 2

Assumptions:

- All non-renewable resource revenues over and above the minimum amount prescribed for program spending be put into the *Future Fund*;
- Resource revenues fall next year (as per Budget 2008 targets) and then rebound to the ten-year average level of \$9.6-billion, growing at 3 per cent each year (ten-year average inflation rate);
- Other revenues continue to grow at 6.5 per cent each year (ten-year average);
- Program spending grows at 5.1 per cent per year (ten-year population and inflation growth rate average);
- Interest is generated in the *Future Fund* at a rate of 4.5 per cent (expected long-term return of *Alberta Heritage Savings Trust Fund*);
- \$5.2-billion from the *Sustainability Fund* be used to start-up the *Future Fund*;
- 50 per cent of interest revenues are sent to the General Revenue Fund;
- 50 per cent of interest revenues are retained within the *Future Fund*.

Table 2 – Scenario 2 – Financial Information (in millions) 2008-09 to 2024-25

Year	Resource Revenue (RR)	RR used for spending	RR into Future Fund	Other Revenues (OR)	Total Revenues	Program Spending	Surplus	Future Fund Balance	Annual Interest Revenue
08-09	\$9,266	\$7,300	\$1,966	\$27,339	\$34,639	\$34,586	\$53	\$5,153	\$232
09-10	\$9,544	\$7,100	\$2,444	\$29,121	\$36,384	\$36,343	\$41	\$7,235	\$326
10-11	\$9,830	\$7,000	\$2,544	\$31,020	\$38,242	\$38,189	\$53	\$9,842	\$443
11-12	\$10,125	\$6,900	\$2,930	\$33,043	\$40,227	\$40,129	\$98	\$12,607	\$567
12-13	\$10,429	\$6,700	\$3,729	\$35,198	\$42,254	\$42,167	\$87	\$15,821	\$712
13-14	\$10,742	\$6,400	\$4,342	\$37,493	\$44,341	\$44,309	\$32	\$19,906	\$896
14-15	\$11,064	\$6,100	\$4,964	\$39,938	\$46,594	\$46,560	\$34	\$24,696	\$1,111
15-16	\$11,396	\$5,800	\$5,596	\$42,542	\$49,022	\$48,925	\$98	\$30,215	\$1,360
16-17	\$11,738	\$5,300	\$6,438	\$45,316	\$51,437	\$51,410	\$28	\$36,491	\$1,642
17-18	\$12,090	\$4,800	\$7,290	\$48,271	\$54,056	\$54,021	\$35	\$43,750	\$1,969
18-19	\$12,453	\$4,200	\$8,253	\$51,419	\$56,790	\$56,765	\$25	\$52,025	\$2,341
19-20	\$12,826	\$3,500	\$9,326	\$54,772	\$59,655	\$59,649	\$6	\$61,448	\$2,765
20-21	\$13,211	\$2,800	\$10,411	\$58,344	\$62,767	\$62,679	\$89	\$72,157	\$3,247
21-22	\$13,607	\$1,900	\$11,707	\$62,148	\$65,943	\$65,862	\$80	\$84,192	\$3,789
22-23	\$14,016	\$900	\$13,116	\$66,201	\$69,301	\$69,208	\$94	\$97,793	\$4,401
23-24	\$14,436	\$0	\$14,436	\$70,518	\$73,063	\$72,723	\$340	\$113,109	\$5,090
24-25	\$14,869	\$0	\$14,869	\$75,116	\$78,043	\$76,417	\$1,626	\$130,090	\$5,854

Chart 10 – Scenario 2 – Future Fund balance (in millions) 2008-09 to 2024-25

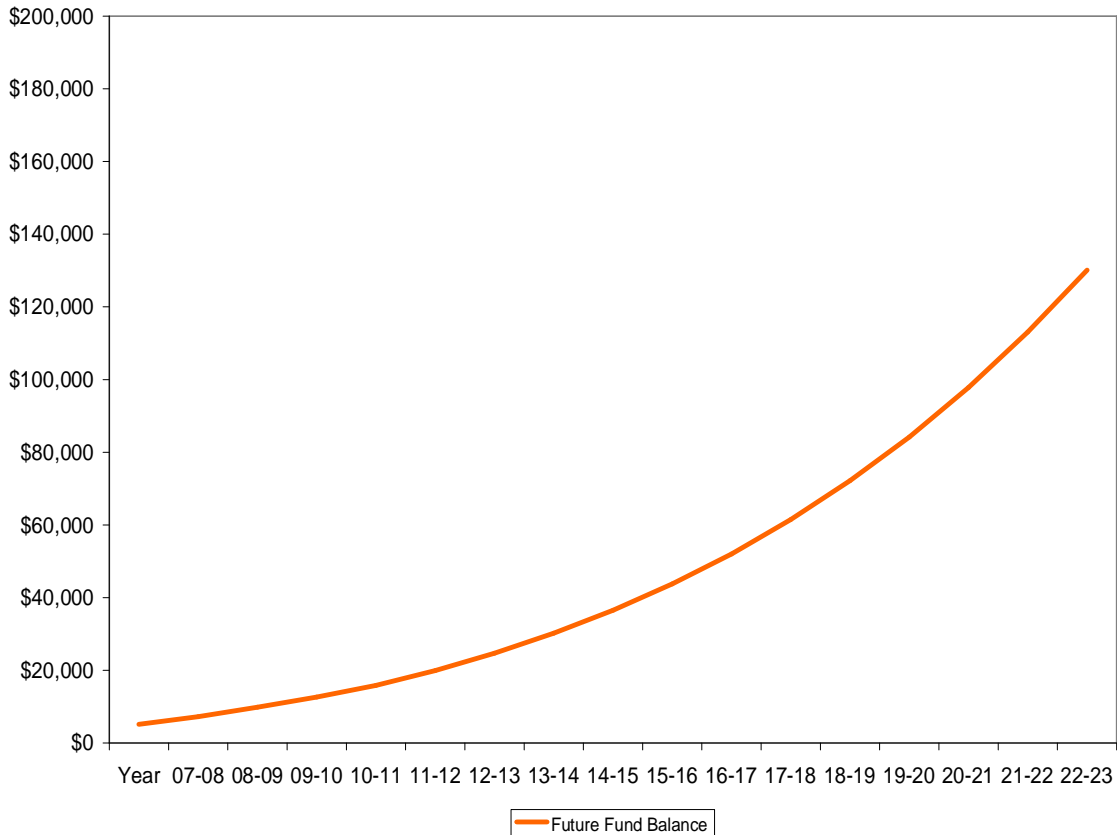
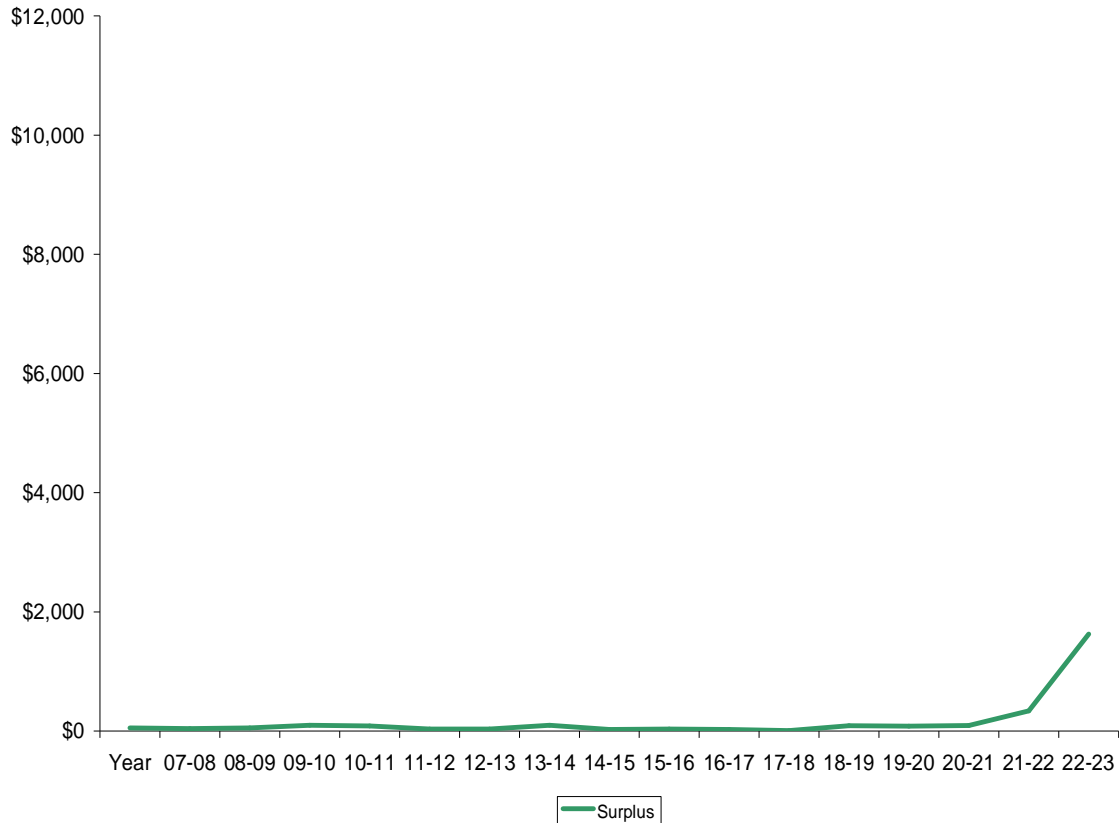


Chart 11 – Scenario 2 – Annual Surpluses (in millions) 2008-09 to 2024-25



As you can see from the two scenarios, the rate of return and whether a spending freeze is enacted right away impact how long it will take to get Alberta completely un-reliant on non-renewable resource revenues. In scenario 1, Alberta is completely un-reliant as of 2017-18 when the fund reaches \$85-billion. In scenario 2, Alberta is completely un-reliant as of 2023-24 when the fund reaches \$113-billion.

CONCLUSION

As previously mentioned, it would be fantastic if the *Alberta Financial Investment and Planning Advisory Commission* and those groups who wish to participate were able to “blue-sky” about what Albertans could achieve if their government were to begin to save.

As clearly shown in the pages previous, this is not a reality. Savings must be done now, not so that income taxes can be eliminated, not so that post-secondary education tuition can be cut, and not so that dividend cheques can be mailed. Savings are the only way to turn Alberta from being reliant on an un-reliable, non-renewable source of revenues to being reliant on a stable, renewable source of revenues.

If the government does begin to save a significant portion of non-renewable resource revenues, the opportunity the “blue-sky” will not be lost, merely delayed. If they continue to refuse, and chose short-term spending over long-term prosperity, this opportunity will be lost.